

DOW THEORY LETTERS INC.

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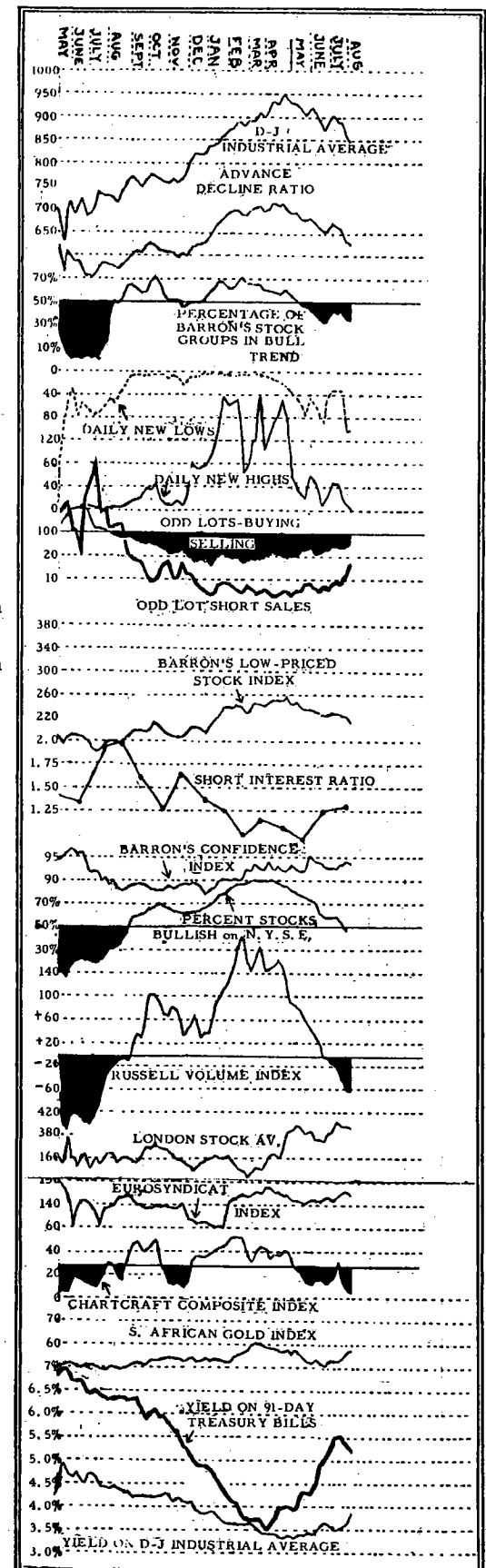
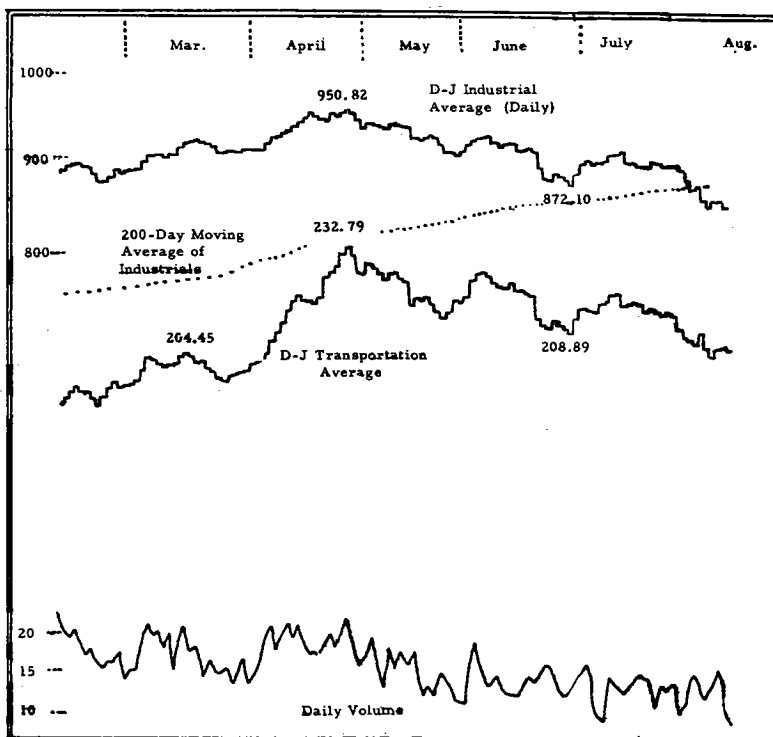
August 11, 1971

Letter 503

THE MARKET: It is only now dawning on the Average American that inflation is a destroyer of values. It is also slowly dawning on U.S. investors that stocks can be placed in the category of values which are destroyed by inflation. If this surprises you (many are still buying stocks as an inflation hedge), consider the facts. Since the bull market peak of 1966, the Consumers Price Index has risen from around 96 (1966) to the June, 1971, peak of 121.5, a rise of 26%. Over the same period, the Dow Industrials have declined from their 995.15 high to a recent low of 850, a decline of almost 14%. Hardly an inflation hedge!

Of course, the answer is that as long as a primary bull market is on, stocks tend to be good hedges against anything including inflation. But by definition, when a primary bull market reaches its final high, the market has discounted the best that can be seen ahead. And this is exactly what occurred when the great bull market ended during early-1966. Since then, the market has been dealing with the deterioration in the economic, social and political fabric of the nation. And despite the rampant inflation, it is obvious that the Averages are now giving much more credence to the bearish factors which are gradually moving into public view.

One of the most critical factors for the stock market is going to be competition with bond yields. Although Treasury borrowing was huge during 1970 and 1971, it is fated to be even bigger from here on as the Administration (following its \$23 billion deficit for 1971) wracks up a possible \$25 billion (or more) deficit for fiscal 1972. Add to this the rising list of Government "agency" borrowers, and then add the corporate and city, municipality and state borrowers, and you have a tidal wave of



Page 2 borrowing to contend with. In his latest bulletin, economist Eliot Janeway warns that "...under 8% bonds find no takers even when the calendar is light," and later he states that in the next chapter "a sharp deterioration in both the economy and the fiscal position will make even 8% bonds difficult to sell".

From the stock market standpoint, it should be remembered that stocks yielding 3% and moving sideways or down are not as good values as bonds yielding 8% or more, and this is the predicament which the still-hopeful "investor" will find himself facing as this bear market progresses.

Readers of these reports can hardly be surprised at the recent turn of events. All through the first quarter of 1971 and as late as April and May the majority of services were waxing poetic regarding the glowing future for the market and the economy. I steadfastly maintained that we were in an upward correction in a continuing primary bear market, and that the 1970-71 bulls were dancing light-heartedly on the thinnest of ice. The dangerousness of that "bull trap" was outlined in every technical and fundamental study I could come up with. I am happy to say that the great majority of my subscribers have avoided the severe decline since April.

On the week ending July 30, the Dow dropped under its 200-day moving average for the first time since August, 1970 (see chart on page 1). At present the moving average is still climbing, and in the past when this has been the case there has usually been a later rally which has taken the Dow temporarily back above the moving average (which now stands at around 865) prior to the next and more serious downward plunge. Since the market is now somewhat "oversold", it would not surprise me to see some sort of a rally which could even bring the Dow back to the 870-900 area, and in so doing we would witness the "usual" rally back over the moving average. This, if it occurs, would provide an excellent selling opportunity for new subscribers who are still holding stocks.

I hasten to note, however, that primary movements can be very intense and persistent, and this could be particularly true following a violent counter-primary movement such as the upward correction of May, 1970 to April, 1971. Therefore, it is never wise to insist that the market "must" do this or that, simply because it has done so often in the past. The fact is that the market can do anything, and I certainly would not count on an upward correction which would take the Dow back above the moving average or back to say the 900 area.

My Dow Theory policy all along has been to stay out of all rallies and declines in this primary bear market. Experience in bear markets strongly indicates that for every speculator who scalps a few profits on the upward corrections, there are dozens who are wiped out on the inevitable declines. In the end (or before the bear market breathes its last), perhaps 95% of all investors and institutions will suffer severe losses. In other words, very few are gifted enough or lucky enough to be able to make or even retain their equity when the major or primary trend of the market is down.

I have been drawing attention to the new lows registered by IBM and GM. The first has been considered America's largest and greatest growth company, the second is the world's largest manufacturing company. It is most unusual to see both of these great, bellwether stocks striking new lows on the same day, but this is what occurred on August 3. In fact, on that day three other Dow stocks broke to lows for the year, and these included Int. Harvester, Int. Nickel and United Aircraft.

It was notable that on August 5, as the Industrial and Transport Averages finally rallied, the D-J Utility Average closed at 112.73, a new low for the year (and a low unnoticed by almost everyone). Finally, last week (see study in Letter 500) the bullish percentage of the 30 Dow Industrial stocks dropped to a low for the year at 20%, while the bullish percentage of all N.Y.S.E. issues sank below the critical 50% level to 45%. This is the lowest bullish percentage since mid-1970.

THE PICTURE: The secret is out: the election issue for 1972 is not going to be the Vietnam War. The issue (and it is already the issue today) is the economy. And since this is a primary bear market, that means trouble for the Administration. Signs of that trouble are becoming patently clear in the public bickering between Mr. Nixon and Mr. Burns, Chairman of the Federal Reserve Board.

It wasn't too long ago that Mr. Nixon brought his "friend and trusted adviser" Arthur Burns into the Fed. The trouble began when Burns would not go along with Administration projections of a \$1,065 billion GNP for 1971. Then Mr. Burns started talking about persistent inflation and the necessity for an "incomes policy". Next Mr. Burns announced that confidence was lacking in the U.S. The final straw came a few weeks ago when Burns testified before the Joint Economic Committee that there has not been any "substantial progress" against inflation.

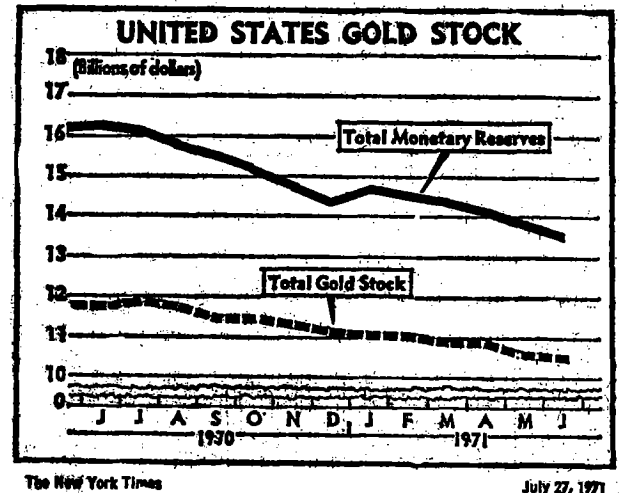
The latest action in the gathering political fiasco was the "release" of rumors that the President was going to double the size of the Fed and bring it under the executive branch of the government (a rumor later denied). The fact is that the Administration, the Fed and the Administration economists are now engaged in something akin to cat-fighting, a scene hardly calculated to inspire business and the consumer. All the "name" economists from Mr. Galbraith ("I think it is a serious state. Prices are

running away, and I wouldn't be surprised to see a strong trade-protectionist movement again") to Mr. Rinfret ("Everyone has lost confidence in the U.S. because of the capital outflow. Europe is flooded with our money, and there may be another devaluation in the making. It just couldn't get worse") are starting to speak out against what they see.

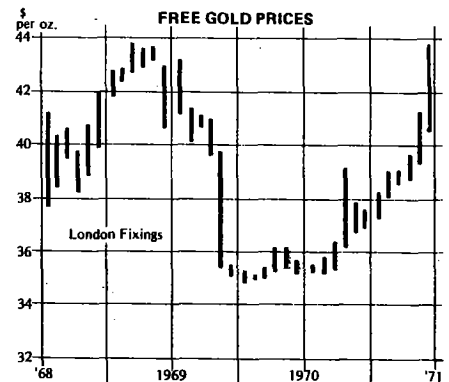
But the Administration continues to insist that the sun is shining 365 days a year, and the absurdity of the situation seemed to have reached new heights when Ron Ziegler (White House Press Secretary) announced that the 1971 budget deficit of over \$23 billion is "a healthy thing". He has not yet commented upon what appears to be the first U.S. trade deficit since 1893 in the making, but one can only wait breathlessly for the latest White House fantasy-pronouncement.

In June, U.S. international monetary reserves (see chart) fell to \$13.5 billions, lowest level since 1938. Gold reserves, if we include what is owed the IMF, fell below what has long been considered the critical level of \$10 billions. The pressure on the dollar continues, and if anything, the potential pressure was vastly increased last week.

In a single week we saw an incredible rail settlement in which wages are to rise 42% in 42 months. A day earlier steel strikers won a 31% wage boost over the next three years, a settlement adding 15% to the ailing steel industry's costs in the first year. The next day steel prices were raised 8% as a starter. Commenting on the steel settlement, the Wall Street Journal talked about long-run "serious economic pressures that may force a reshaping of the steel industry if it is to survive".



Over the weekend a Congressional panel suggested that if foreign nations do not up-value their currencies to help out the dollar, the U.S. should go off gold. At the same time the U.S. decided to draw \$862 million from the IMF (a decision which suggested that the U.S. ability to finance its payments deficits was becoming strained). In the face of these numbing news items, the gold market boomed on Monday (Aug. 9) with gold rising in London to \$43.93, a new high. In place of the regular chart, I am including a long-term chart of gold (courtesy of Holt Investment Service). Interest in gold coins (U.S. "Double Eagle", "British Sovereign") has boomed, and huge volume is reported in these coins (since it is legal to own these all gold coins, legal because they were minted before 1934:)



Conclusion: Currently, we are witnessing the incredible spectacle of booming wage settlement, whopping price increases and a run-down of U.S. reserves as the world's largest producer relentlessly prices itself out of international markets. The prevailing wage pattern is a 30% boost over three years, and it may now be said that greed is king in America. If it could ever have been said that corporate greed was running ahead of workers' greed in this nation, forget it. At long last, the unions have caught up. Obviously prices will have to be boosted to approximately match current wage boosts, and this means roaring inflation or collapse in the next few years.

I believe the consumer is close to panic as the American economy, beset by unemployment, sluggishness and inflation, presents an ever more ominous picture. The result will be a rising trend by the average American to protect himself from his government and his fellow men. The final result will not be pleasant to see.

ACTIVITY: Every market student attempts to determine (often through technical studies) where the important activity is taking place. Two methods I use are shown on the page 4 charts. The first appeared initially in Letter 500. It is the monthly total of secondary distributions as compiled each week in Barron's.

The secondary distribution is one of the common methods by which large investors and institutions seek to distribute big blocks. As seen on the chart, the late-1968 and early 1969 period was characterized by heavy secondary activity. This suggested that many large blocks of stocks were distributed prior to and during the 1969-70 collapse.

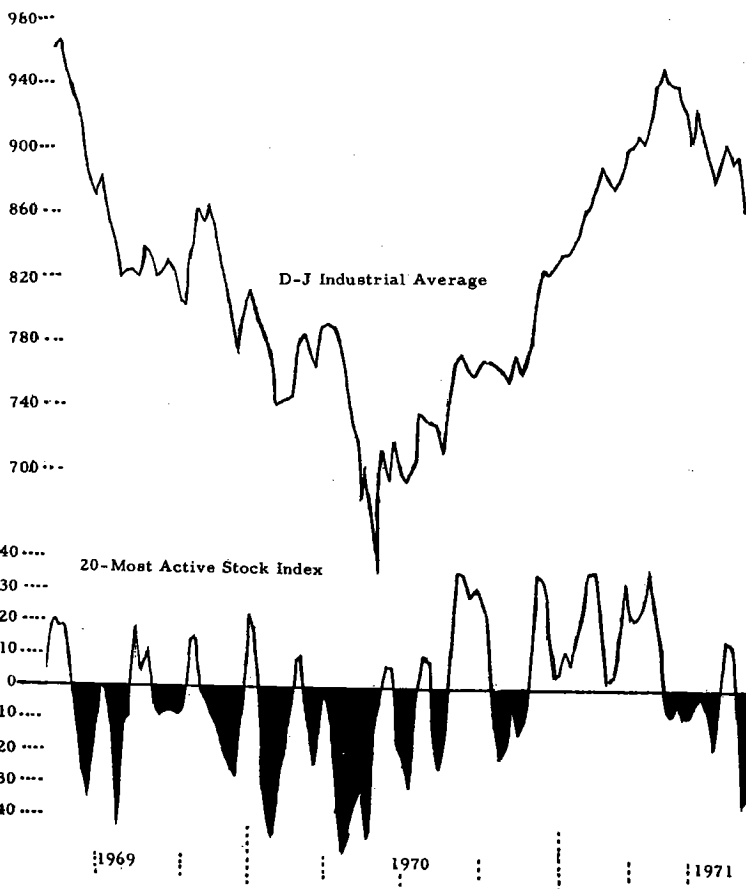
The recent secondary figures are just as interesting. For the month of May there were a record 44 secondaries, June provided 41, and July showed 38. This three month total of 123 is the highest of which I have any record. It indicates that heavy dis-

Another chart which provides technical indications of "where the action is" has been up-dated from Letter 478. This is the chart of the most active stocks (for the week) on the N.Y.S.E. The figures on the chart are arranged on a three-week moving average (or three-week totals). Each week the 20 most active stocks are studied. The plurality of stocks advancing and declining is computed. For instance, if 16 stocks advanced and 4 declined, the plurality would be a plus 12. Then pluralities for the last three weeks are computed and entered on the chart.

It is notable that the index touched a peak of 38 on the week of February 12, 1971. That week saw the Dow close at 888. On the week of April 16 the index again registered 38. But at that time the Dow was 940. In other words, with the Dow 50 points higher the most active index failed to better its earlier peak. That action proved to foreshadow the trouble which we have seen since the April highs.

Last week the index dropped to minus 36, its lowest level since May, 1970. This indicates heavy leadership on the downside, and corresponds with many of the other indicators appearing in this report (for instance, the Russell Volume Index on page 1).

INTERNATIONAL TROUBLES: I have often been asked whether this bear market will affect just the U.S. or the entire world. My answer is that it will affect everybody, but perhaps to varying degrees. I have been asked whether a world depression would affect the Communist nations as well. My answer there is that I believe it would. Price collapses and deflation mean contraction everywhere, and contraction in turn means a slowdown in volume and a "digging in" among corporations and individuals as they begin the wait for the rough times to blow over.

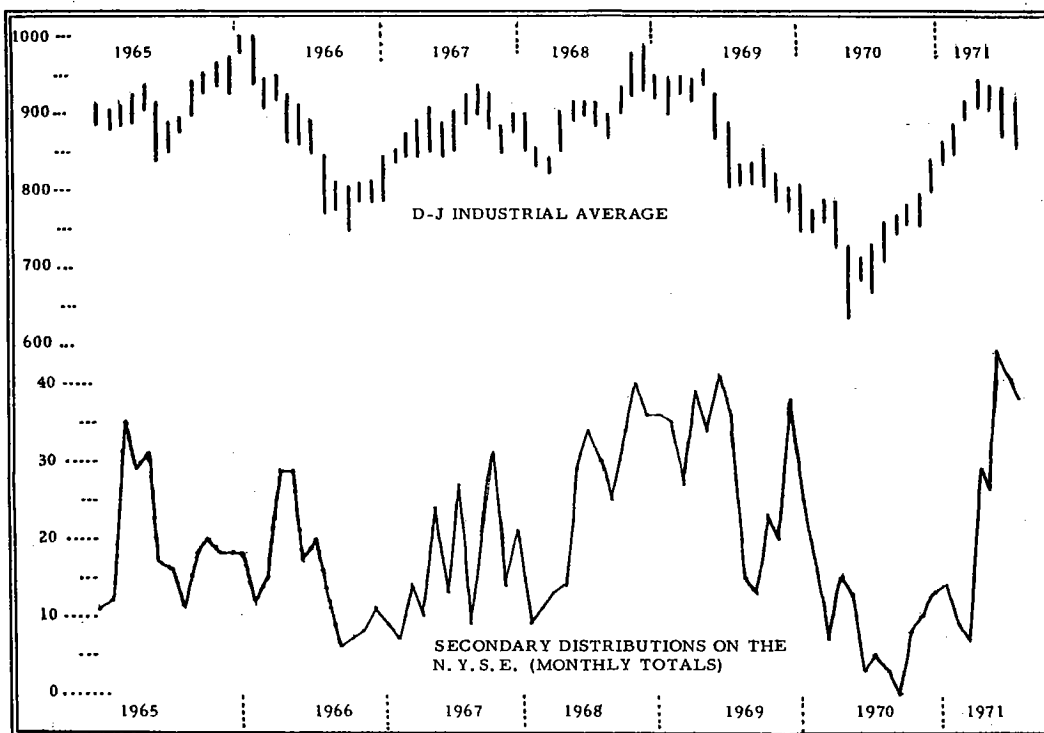


Tanker Rates on Freight Hit Record Low

LONDON (AP) — Tanker freight rates have reached a new world rock bottom, brokers said Tuesday. They estimated the total tonnage of oil carriers laid up at around 500,000 deadweight tons.

This compares with less than 80,000 deadweight tons idle at the beginning of the month.

One broker reported that last week some tankers were laid up for days in the Persian Gulf for lack of cargo although they were offering the lowest rates since the end of World War II and below the rates practiced just after the Suez Canal reopened in 1956 after the Egyptian campaign.



On July 7 this AP clip (on page 4) appeared regarding a record slump in oil tanker rates as shipping tonnage piles up, unused. One of the best gauges of world trade is shipping tonnage and unused capacity. These news clips seem to be telling an ominous story, one that we will be hearing much more about in coming months.

THOUGHTS: As indicated in the last Letter, I spent a few days in San Francisco, and that is why this report is a few days late. I must say that I received many "bad vibrations" from this famed "flower city of the Golden West". I found prices outrageously high (probably about the same as New York). I found the city itself crowded and literally choked up with autos (it's almost impossible to park in San Francisco, a severe inconvenience to the average visitor).

While I was there the San Francisco Chronicle (which, by the way, has a very incomplete financial section) ran an article stating that hippies were a detriment to the city and a constant source of annoyance to tourists. I disagree. I found the hippies to be the most interesting thing in San Francisco (although we have plenty of them in San Diego), and I found that high prices and general "graspingness" of the staid, local San Francisco businessmen to be my own greatest source of annoyance. In short, I found San Francisco to be an expensive, over-crowded, frantic city, and as we flew back to San Diego I remarked to my wife, "Look at those thousands of miles of empty desert land below us. I'll bet you could put the entire population of the U.S. in inland California, and you'd still have lots of space left in this state." I believe that desert living is going to be the coming thing in the U.S., and if so, I feel it will be an excellent trend. The vast, unused desert areas of the U.S. are standing there waiting to be populated. How people can stand living like sardines (I did so myself for 35 years in New York) in the big cities is now utterly beyond me.

Speaking of our overcrowded, high-priced, uncomfortable, frenzied cities, I could not resist including these two articles (on this and the next page) which recently appeared in the New York Times. I feel that both of these deserve to be read; they proved very thought-provoking to me. The first by C.L. Sulzberger was sent by a subscriber (the underlines are his),

the Apocalypse

By MIGUEL SERRANO

In 1960, following the earthquake which destroyed many Chilean cities, Dr. C. G. Jung wrote: "Even though today's scientists may reject the idea, the earth seems to be in tune with the destructive fury of mankind." Jung was establishing a close relationship between the spirit of mankind and the spirit of the earth, suggesting that the earth has a soul of its own. The visionary Swedenborg made similar suggestions. He wrote that the heavens took the form of a man's body. I believe that the earth is also divided into parts, like the body of a man. It has a head, a brain, a solar plexus, a heart, and sexual organs. Since these are all different, it follows that the people living in various parts of the world are not the same. If we would accept this reality, everything would be much clearer, for then we would not try to impose our way of life on other people who do not want to be like us.

Civilization represents the different ways in which men have organized themselves, and history is a rhythmic expression of the ways in which men from different places have imposed themselves on others. Each civilization thinks it is the best and the last, and that it will go on forever. The mechanistic civilization of the Western white man, which enables him to visit the moon, is such a civilization. But in fact it is only the expression of men with a rationalist impulse, and will soon be replaced.

Dr. Jung once explained to me his belief that there were a number of separate centers of consciousness in the human body. He said these were *chakras*, and that each was capable of producing thought. He told me of a conversation he had with the chief of the Taos Indians who told him that white men were covered with wrinkles because they were crazy. They were crazy because they only thought with their heads. Dr. Jung pointed out that the Greeks believed that they thought with their hearts while the Japanese thought with their solar plexus, the *manipura chakra*. When they commit *hara-kiri*, they open themselves up so that the soul can get out.

As people and regions are different, so I believe that South America is governed by a different sign, a delicate heritage imposed by its mineral landscape. But so far this sign has not been recognized. Instead it suffers from a history imposed from without, and this means there is a profound disequilibrium between man and his landscape. The land pulls in one direction and Europeanized man in the other.

The violence exploding all over the planet is a sign of this trouble. It may seem that the guerrilla warfare and urban upheaval typical of South America may be directed against North American imperialism, but this is only a surface indication of a much more profound movement. This is a pendular alteration with psychological implications upon the living body of the earth and signaling the arrival of a new man directed by other forces or centers.

This great crisis in which a civilization seems to be disappearing offers extraordinary possibilities for individual salvation. It is a time for the individual to try to establish an equilibrium between what is within and what is without, to go into the depths to discover the cold fire, the inner complementarity, so as to return transformed and transfigured. This challenge involves activating all of man's possibilities, of alerting all of his *chakras* or centers of consciousness.

There are many people concerned with social problems and social change. These are the "crazy people who think with their heads." What is more fundamental, although it can only be the work of a very few, is to go under, to submerge oneself in anonymity in order to preserve human individuality. As Dr. Jung has said, "The work of a private man has repercussions in eternity." Or, to use the words of an ancient Chinese proverb, "If a solitary man sitting in his room thinks the right thoughts he will be heard a thousand miles away."

These words may sound romantic or meaningless today, but unless this task is undertaken, there will be no salvation for man or for the earth. There will only be an artificial union of mankind created by technology and political slogans. These promise little more than a mechanistic or dictatorial regulation of the individual, producing a collective slavery of one kind or another. The new man, who is already born, requires more than that, and individuals all over the world dream of something else.

There is only one way to go beyond the monotonous argument of history. One must develop not one center or *chakra* but all of them at once, to become a total man. This is the essential task as the apocalypse approaches.

Miguel Serrano is the author of "C. G. Jung and Hermann Hesse: a Record of Two Friendships," and other books. He has been Chile's Ambassador to India, Yugoslavia and Austria.

and I somehow missed this piece in my own copy of the Times. In this article, Sulzberger discusses the declines of great nations, and the morality and ambitions which prepared the way for those declines.

The second article by Miguel Serrano I found very fascinating and not as "far out" as many readers may think. Today, our youth is turning to matter of the spirit. Many of them are engrossed in Yoga, Indian lore, or religion in the highest sense and a return to matters dealing with the organism and its relation to itself, God and the world. To the casual observer, this rise of interest in man's spirit may be obscured by the emphasis on free living, drugs, sex, immorality and "laziness".

The older generation cannot understand that today's youth has become disillusioned with war, making money for the sake of making it, big government and its gross, meddling inefficiency, and its monstrous, staggering budgets and wastages. Many of today's youth have turned away from all these matters and have decided instead, to try to find the meaning of life somewhere else.

I have never attended church or synagogue although I happen to be a Jew. Nevertheless, I find the words of Jesus both wise and inspiring. I often wish more people would stop spouting fake morality and read what Jesus actually said. For instance, Jesus said (St. Mathew -7): "Therefore I say unto you, take no thought for your life, what ye shall eat, or what ye shall drink; nor yet for your body, what ye shall put on. Is not the life more than meat, and the body more than raiment? Behold the fowls of the air: for they sow not, neither do they reap, nor gather into barns; yet your heavenly father feedeth them. Are ye not much better than they?"

I often wish my generation could have understood those words. Jesus was interested in matters of the mind and soul, not in matters of the body. One thing I have learned very recently is something which my brilliant wife has known for years. A spiritual leader of the 1940's named Florence Shinn called it "the Law of Supply". The law of supply states that faith, not greed will bring us what we need. It also states that in giving, one receives, whereas in taking, one loses. And I am afraid that people in the U.S. have been on the greedy, taking end for far too long. Therefore it would not surprise me if great losses were not in store, as suggested by these two articles.

In my younger days I spent much time making money, and it brought me little happiness. I now have six young people (aged 18 to 25) living with me and my family, and I have discovered that I am much happier with the vastly increased expenses. And everything seems to be provided for, and I worry less than ever about money.

FRIDAY, JULY 16, 1971

By C. L. SULZBERGER

ROME — When President Nixon gloomily reflected last week on whether the United States was destined to emulate ancient Rome and fade away in a welter of decadence, the people of this city were given particular food for thought. For, since the days of its Republican and Caesarian grandeur, Rome has declined with a kind of baroque solemnity and even today is entering on new and perplexing troubles.

Commenting on pseudo-classical architecture of U.S. public buildings, Mr. Nixon admitted: "sometimes when I see those columns I think of seeing them in Greece and in Rome and I think of what happened to Greece and Rome and you see only what is left of great civilizations of the past. As they became wealthy, as they lost their will to live, to improve, they became subject to the decadence that destroys the civilization. The United States is reaching that period."

Edward Gibbon devoted his life to investigating the reasons for Rome's decline and fall and discerned a pattern. As decadence became evident, he wrote that Decius "soon discovered that it was impossible to replace that [Roman] greatness on a permanent basis, without restoring public virtue, ancient principles and manners, and the oppressed majesty of the laws."

But successive Roman leaders failed to support such principles. Thus, Carinus "abandoned himself to the luxury of the capital and to the abuse of his fortune . . . devoted to pleasure, but destitute of taste; and though exquisitely susceptible to vanity, indifferent to the public esteem."

Meanwhile "great numbers of provincials rather chose to live as exiles and outlaws than to support the weight of civil society." And a situation developed in which "every teacher, either of truth or of falsehood, every founder, whether of a virtuous or a criminal association, might easily multiply his disciples or accomplices."

The citizens of the Roman republic first abandoned leadership responsibilities to an aristocratic and eventually autocratic class and then that class gradually lost its moral and intellectual distinction and capacity to lead. It is known that President Nixon, long before the latest crisis on Vietnam and the economy, had been disturbed by what he considered a leadership crisis in every branch of American society.

Decadence is a special disease unrelated to intellectual evolution. Three basic moments in European history

critically changed human destinies but none involved political decay. The first was the quarter century between Aristotle and the Stoics when the all-powerful position of the state yielded to conceptions of individual liberty.

The second, following Machiavelli, produced the realization that no one could be both a good man and a good statesman. And the third, stemming from the eighteenth-century romantic movement, fostered new lines of political thinking including the Italian Fascist aberration.

But decline of great nations responds to other human rules. Almost inevitably decadence follows an era when a country has become excessively prosperous and, consequently overconfident, has extended its authority beyond the realm of its capacity. It then suffers a moral decline when it finds its dreams of grandeur are unsound.

Americans had always assumed themselves to be a chosen people anointed with a New World innocence untainted by Old World corruption. When they were drawn into that Old World they excused the adventure by moralistic reasoning which sought to explain that it was a national and ethical duty to oppose the evil of Communism wherever it appeared, just as Fascism-Nazism had previously been opposed.

These Manichean assumptions have now begun rapidly to disappear from the American mass consciousness just as the assumption of inherent virtue in Roman citizenship disappeared or the British belief in a benevolent obligation to carry the "white man's burden" into Asia and Africa while assuring markets for the Midlands textile factories.

Mr. Nixon's pessimistic musing was notable for its honesty. Contemporary indications are that he will have no more success than did Decius in halting the decline "without restoring public virtue, ancient principles and manners, and the oppressed majesty of the laws."

This has suddenly become America's primordial problem. As the President said: "The critical question is whether the United States will be a healthy nation in terms of its moral strength." When that same question was posed in ancient Rome the answer was a flat no.

Are the above strange words to find in an investment service? Perhaps, but Charles Dow always dealt with and talked about "values". I believe that an investment service can deal with all sorts of values, not just monetary values.